



# MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

FOURTH YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF SCIENCE (AGRIBUSINESS MANAGEMENT)

AGB 412: CORPORATE AND INTERNATIONAL FINANCE

DATE: 23/10/2020

TIME: 2:00 – 4:00 PM

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## INSTRUCTIONS:

*Answer question one and any other two questions.*

### QUESTION ONE (COMPULSORY) (30 MARKS)

- a) Explain Six factors that determine the capital structure of firms. (6 marks)
- b) The following financial statements relate to the Zoma Ltd. for the year ended 31 December 2017

Assets	Shs.	Liabilities & Net worth	Shs.
Cash	28,500	Trade creditors	116,250
Debtors	270,000	Notes payable (9%)	54,000
Stock	<u>649,500</u>	Other current liabilities	100,500
Total current assets	948,800	Long term debt (10%)	300,000
Net fixed assets	<u>285,750</u>	Net worth	<u>663,000</u>
	<u>1,233,750</u>		<u>1,233,750</u>

#### Required:

- Calculate the Working Capital of Zoma Ltd. (6 marks)
- c) Explain the following terms as used in Foreign Direct Investments
- i. Greenfield Investments
- ii. Cross-Border Mergers and Acquisitions (4 marks)
- d) Business Failure fall into three types. Identify and explain any two types of business Failure. (4 marks)

e) ABC Ltd needs Shs. 10M for the installation of a new factory. The new factory expects to yield annual earnings before interest and tax of Shs. 500,000. In choosing the financial plan, ABC Ltd has an objective of maximizing earnings per share.(EPS) The Company proposes to issue ordinary shares and raising debt of Shs.300,000, Shs.1,000,000 and Shs. 1,500,000. The current market price per share is Shs.250 and is expected to drop to Shs.200 if funds are borrowed in excess of Shs.1,200,000. Funds can be raised at the following rate:

0 - Upto Shs.300,000	8%
Shs.300,000 - Shs.1,500,000	10%
Shs.1,500,000 - And above	15%

Assume a tax rate of 30%,

- i) Advise the Company. (5 marks)
- ii) How many shares of common stock should the company issue to maximize EPS? (3 marks)
- iii) What would be the market price for the shares in (ii) above? (2 marks)

## QUESTION TWO (20 MARKS)

- a) Dividend policy refers to the explicit or implicit decision of the board of directors regarding the amount of residual earnings (past or present) that should be distributed to shareholders of the corporation.. Explain five factors that should be considered when making this important decision. (5 marks)
- b) P and Q two firms that are operating in the same industry and have the following characteristics

	Firm P	Firm Q
Selling price per unit	Shs.3	Shs.3
Variable cost per unit	Shs.1.80	Shs.2.30
Fixed costs	Shs.30,000	Shs.70,000

For the year 2017, their level of output had reached 120,000 units and it seems that market conditions for the year 2018 had greatly improved necessitating the output level to be increased to 150,000 units per year.

### Required:

- i) Calculate the degree of Operating Leverage for both firms for the year 2018. (6 marks)
- ii) From your results above, which business has a higher business risk and why? (4 marks)

- c) Explain the following dividend theories.
- i) Tax preference Theory
  - ii) Signaling Hypothesis.
  - iii) Bird –in-hand Theory
  - iv) Clientele Effect.
  - v) Dividend irrelevant Theory (5 marks)

**QUESTION THREE (20 MARKS)**

- a) Normal Business Failure starts with simple poor under performance that result in poor profitability. Over time, continued under performance translates into reduced reserves and investment and the balance sheet starts to show signs of distress. Explain five symptoms of normal business failure. (5 marks)
- b) Many firms locate their production overseas rather than producing goods in their own country and exporting from their home country or licensing production to a local firm in their domestic country. Explain five key factors that are important in firms' decisions to invest overseas. (15 marks)

**QUESTION FOUR (20 MARKS)**

- a) The following information relate to a ABC Company Ltd. for the year ended 31 December 2019.

Annual Sales Shs.10,000,000  
Cost of Sales 75% of sales  
Purchases 65% of Cost of Sales  
Average age of inventory 60 days  
Average Collection Period 40 days  
Average Payment Period 35 days

**Required:**

Calculate the amount of resources ABC Ltd. has invested in the Cash Conversion Cycle. (8 marks)

- b) i) Distinguish between Mergers and Acquisitions. (3 marks)
- ii) There are three basic Legal procedures that one firm can use to acquire another firm. Explain clearly these procedures. (9 marks)

**QUESTION FIVE (20 MARKS)**

- a) Identify and explain Five benefits of and the disadvantages of debt financing to a business. (5 marks)
- b) The following are the financial statements of ABC Ltd. For the year ended 31st December, 2017.

**Statement of Financial Position as at 31st December,2017:**

	Sh. '000'		Sh. '000'
Cash	480,000	Trade creditors	860,000
Debtors	640,000	Short-term notes Payable	840,000
Stock	2,080,000	Long-term debt	1,600,000
Equipment	1,600,000	Shareholders' equity	1,500,000
Motor vehicles	<u>1,000,000</u>	Retained earnings	<u>1,000,000</u>
	5,800,000		5,800,000

**Income Statement for the year ended 31st December,2017**

	Sh. '000	Sh. '000
Sales		6,000,000
Less: Cost of sales		3,600,000
Gross profit		2,400,000
Deduct: Selling expenses	600,000	
Administrative & gen. Expenses	1,120,000	
Interest charges	235,600	1,955,600
Profit before taxation		444,400
Taxation		177,760
Net profit		266,640

**Additional information:**

The firm has 100,000 ordinary shares. The current market price per share is Sh. 18.

**Required:**

Using **Altman's Z-score** assess the firm's probability of failure (15 marks)